

Senate Budget and Fiscal Review
SUBCOMMITTEE NO. 1

EDUCATION
Jack Scott, Chair
John Vasconcellos
Bob Margett

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Room 112

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I. STUDENT FEES

DEVELOPMENT OF A LONG-TERM STUDENT FEE POLICY. As part of the Governor's 2004-05 Budget package, the Administration proposes to re-establish a statutory long-term student fee policy. The previous fee policy expired in 1996 and the Legislature has not taken action to establish a new policy since. The Governor's proposal, which is contained in Senate Bill 1553 (Karnette), would link undergraduate student fee increases to changes in per capita personal income, with an overall cap of a 10 percent increase in any given year. Graduate fees would be increased at a level deemed appropriate by UC and CSU governing boards until the fee level reaches a point that is 50 percent higher than the level of undergraduate fees; after that time, both undergraduate and graduate fees would increase at the same rate.

This measure was heard by the Senate Education Committee on April 14, 2004 and moved, without prejudice, to the committee's Suspense File. It is unclear when or if the measure will continue through the legislative process.

In addition to the Administration's proposal, the Office of the Legislative Analyst (LAO) offers an alternative fee proposal which would set and adjust student fees based on a fixed percentage of students' total education costs. In the current academic year (2003-04), students at the University of California (UC), California State University (CSU) and California Community Colleges (CCC) are paying 26 percent, 17 percent and 12 percent, respectively, of their total education costs.

A. UC AND CSU UNDERGRADUATE AND GRADUATE STUDENT FEE INCREASES. The Governor's 2004-05 Budget proposes to increase undergraduate fees at both the UC and CSU by 10 percent and increase fees for graduate students by 40 percent. Combined, these two increases are expected to generate approximately \$160 in revenue to the UC and CSU; this revenue will be used to offset the more than \$660 million in General Fund reductions proposed for UC and CSU in the 2004-05 fiscal year.

LEGISLATIVE ANALYST. In response to the Governor's proposal, the LAO recommends that the Legislature adopt the proposed 10 percent undergraduate fee increase, citing the increase as "modest".

On the issue of Graduate student fees, the LAO recommends increasing graduate-level fees, but not to the 40 percent level proposed in the Governor's Budget. Instead the LAO recommends raising fees 30 percent, citing that a 40 percent increase cannot be defined as "moderate". If other revenues are not raised to compensate for the LAO's proposed reduction, it would cost the state an additional \$33 million (\$18 million at UC and \$15 million at CSU) over the funding levels proposed in the Governor's Budget.

STAFF NOTES. In calculating its fee revenue assumptions, the Department Of Finance proposes assessing the graduate-level fee increase (40 percent) on all post-baccalaureate degree students at the UC and the CSU – including teaching credential candidates. Given the state's desire to train, recruit and retain teachers, staff recommends that this class of

students be included instead under the category of “undergraduate” students for purposes of assessing fee increases.

Ultimately, staff would recommend approving the fee revenue figures for undergraduate and graduate students contained in the Governor’s Budget, but specifically allow the UC and CSU governing boards to determine the actual percentage increases. It is important to note that, in the absence of current law guiding the setting of student fees, the UC and CSU governing boards have retained authority in this area. Allowing the governing boards to set the exact fee level would, for example, allow the institutions to compensate for the loss of revenue from teacher credentialing candidates, and to develop alternative fee options for graduate students.

However, staff notes that the Department of Finance has indicated that it is currently in conversations with UC and CSU regarding this proposal and that an update may be included as part of the May Revision. As such, staff recommends that this issue be held open pending the May Revision.

Undergraduate Student Fees				
	<u>UC</u>		<u>CSU</u>	
	Resident	Nonresident	Resident	Nonresident
1994-95	\$4,111	\$11,810	\$1,584	\$8,964
1995-96	4,139	11,838	1,584	8,964
1996-97	4,166	12,560	1,584	8,964
1997-98	4,212	13,196	1,584	8,964
1998-99	4,037	13,611	1,506	8,886
1999-00	3,903	14,077	1,428	8,808
2000-01	3,964	14,578	1,428	8,808
2001-02	3,859	14,933	1,428	8,808
2002-03	3,859	15,361	1,428	9,888
2002-03	4,017	16,396	1,573	10,033
<i>(fees increased mid-year)</i>				
2003-04	5,530	19,740	2,016	10,506
2004-05	6,028	22,504	2,250	12,420

Note: Actual fees may vary by campus depending on the particular level of campus-based fees.

Fees for UC professional school students in such disciplines as medicine, dentistry, law, veterinary medicine and business have yet to be determined. Nursing fees are proposed to remain constant at an additional \$2,925 annually.

B. INCREASE IN NONRESIDENT STUDENT FEES. The Governor's Budget proposes to increase the surcharge on nonresident students by 20 percent, generating approximately \$48.8 million in fee revenue (to offset accompanying General Fund reductions). At both UC and CSU, these nonresident charges are assessed in addition to the regular in-state student fee levels.

LEGISLATIVE ANALYST. The LAO recommends that the Legislature approve the 20 percent nonresident fee increase for graduate students; hold constant the nonresident fees for UC undergraduates; and increase nonresident fees by 3.5 percent for CSU undergraduates.

Specifically, the LAO finds that nonresident *graduate* students are paying considerably less than their full educational costs, and as such, should be able to absorb a 20 percent increase. With regards to *undergraduates*, the LAO finds that UC nonresident undergraduate students are already paying more than their full educational costs and therefore recommends that the Legislature deny the proposed fee increases for that population of students. At CSU, nonresident undergraduate students are paying slightly less (approximately \$500) than their full educational costs, as a result, the LAO recommends that fees for this population of students be increased by 3.5 percent rather than the proposed 20 percent. Combined, the LAO's proposal will cost an additional \$29 million (\$18 million at UC and \$11 million at CSU).

STAFF NOTES. While it is important to note that nonresident *undergraduate* students may be paying more than the full cost of education – thus partially subsidizing our California students – the UC and CSU have expressed concern about pricing nonresident students out of the higher education “market”. Specifically, if costs for nonresident students become higher than students are willing to pay, the associated revenues would fail to materialize and the universities would be left with an unallocated reduction. However, given the lower priority of nonresident students for state resources and the lack of available General Fund to “backfill” the revenue needed to implement the LAO's recommendation, staff recommends that the committee approve level of General Fund savings associated with the proposal but allow UC and CSU to raise nonresident tuition between undergraduate and graduate students as they deem appropriate.

C. CCC FEE INCREASES. Fees for California Community College students are set in statute by the Legislature. For most students at Community Colleges, the Governor proposes increasing fees by \$8 per unit – from the current \$18 per unit level to \$26 per unit. However, under the Governor's proposal, community college students who have already earned a Baccalaureate degree would be charged a flat \$50 per unit fee, thereby increasing fees for that population of students by \$32 per unit (from the current \$18 level.)

The Department of Finance (DOF) estimates approximately 25 percent student attrition due to the \$50 fee; further DOF assumes that 4 percent of the remaining students (who would

otherwise be subject to the \$50 fee) would be deemed financially needy thus qualifying to have their fees waived. In total, DOF estimates that this portion of the proposal would result in additional fee revenue of \$18 million.

To implement the differential fee, the Administration is proposing accompanying trailer bill language which would establish the \$50 fee in statute and exempt certain classes of individuals from paying the fee. Specifically, the following groups would be exempted from paying the \$50 surcharge: (1) terminated/laid off workers; (2) SSI and/or TANF recipients; (3) contract education participants; (4) students with financial need; (5) dependents/spouses of National Guard member killed or permanently disabled in the line of duty; (6) nonresident students paying nonresident tuition; and (7) surviving dependents of September 11th terrorist attacks.

LEGISLATIVE ANALYST. In response to the Governor's proposal, the LAO recommends approving both the \$8 per unit increase as well as the \$50 per unit "differential surcharge". In recommending the approval of the \$8 per unit increase, the LAO cites the proposal as modest and finds that increasing fees to the \$26 per unit level actually affords financially-needy students the benefit of receiving additional aid through the federal Pell Grant program.

Alternative Federal Pell Grant Schedule^a	
Per Unit Fee	Pell Grant Amount^b
\$11 through \$17	\$3,713
\$18 through \$25	3,938
\$26 and above	4,050
^a All other community college systems in the nation use the "regular" Pell Grant schedule—in which the maximum award is \$4,050. Currently, the California Community College system must use an alternative award schedule because its fees are so low.	
^b Represents maximum award in 2004-05 for a full-time student. Students attending less than full time receive a Pell Grant award that is reduced proportionally. For example, the maximum award for a half-time student is half that of a full-time student receives.	

With regard to the \$50 differential surcharge, the LAO recommends approving this increase based on the premise that, in a budget composed of finite resources, the proposal would appropriately target the state's higher education subsidies (and General Fund resources) to higher priority areas.

STAFF NOTES. Staff concurs with the LAO's recommendation on the \$8 per unit fee increase, and notes that financially-needy students will continue to have their fees (at the increased level) covered under the Board of Governors (BOG) fee waiver program. Furthermore, the additional financial aid benefits reaped through the Pell Grant program

would provide cash directly into the pockets of financially-need community college students to help cover unfunded costs related to books, housing, transportation and living expenses. As such, staff recommends that the committee approve the fee increase to \$26 per unit.

On the issue of the \$50 baccalaureate degree surcharge, staff would note that many of the targeted students are enrolled in community colleges to gain valuable skills needed to retain their place in the workforce, change jobs, and/or re-enter the workforce after becoming unemployed. While the Governor's accompanying trailer bill proposal exempts some of those students (laid-off workers) from paying the \$50 fee, others are not. While the Administration proposal strives to accommodate laid off and re-entry students, it fails to address the "sticker shock" issue that inevitably accompanies such an enormous jump in fees. In order to take advantage of the proposed statutory exemptions, students would first need to be aware that these exemptions exist and would then need to go through the administrative hurdles necessary to get their fees waived.

As with the other fee proposals, the community colleges have expressed concern over whether the revenue assumptions attributable to the proposed fee increases would materialize. If the fee increases change student behavior and the fee revenues are not realized, then the reduction ends up to be an unallocated reduction to the college system. In conclusion, staff recommends that the \$50 baccalaureate degree surcharge be held open pending the May Revision.

D. PROFESSIONAL STUDENT FEE INCREASES. The Governor's Budget proposes to dramatically *decrease* the amount of General Fund support that the state provides for professional degree instruction at UC and Hastings College of Law (i.e., law, business, medicine, veterinary medicine, nursing, theater/film/television) Exempted from this reduction are any cuts or additional fee increases associated with nursing programs. Specifically, the Governor proposes to reduce the state "subsidy" for professional school students by \$45.6 million (\$42.6 million from UC and \$3 million from Hastings), which is designed to capture a 25 percent reduction in the state subsidy for professional degree students.

The Governor's assumption is that this decrease would be filled by increasing the student fees for professional school students. While the Governor's Budget does not propose increasing fees to a particular monetary level, UC is in the process of determining how the cuts would be implemented among the various professional-level programs and then assessing what level of fee increases would be necessary to capture the lost General Fund. Given the "market" for professional degree education, UC is concerned that increasing the fee too highly will drive students to other institutions and/or out-of-state. Hastings has also indicated that, at a proposed tuition level of over \$19,000 per year, it becomes more difficult to predict student choice and demand.

LEGISLATIVE ANALYST. The LAO supports the assertions contained in the Governor's budget and recommends that the Legislature approve the reduction in Professional School support. Specifically, the LAO finds that fees for professional school students will increase by about 25 percent (or anywhere from 24 to 27 percent), a level significantly less than the 40 percent increase proposed for academic graduate students.

STAFF NOTES. Staff recommends that this issue be held open pending the May Revision.

E. CSU HIGH COST PROGRAMS. The Governor's Budget makes no explicit proposal regarding to CSU's high cost (professional level) degree programs. Under current practice, CSU charges graduate students in masters-level programs like business, nursing, and film/television the same fee level as it does other graduate-level students. At UC, professional school students in these same fields of study pay an additional differential fee which ranges from \$2,900 for nursing students to \$9,000 for MBA students.

LEGISLATIVE ANALYST. The LAO contends that the current fee structure for professional-degree graduate students is inconsistent between UC and CSU and proposes that CSU institute a similar "differential fee" for students in the above-noted three professional degree programs. According to the LAO, if each of the approximately 4,000 students enrolled in the three professional degree programs paid a differential fee of 15 percent more, the LAO believes it would generate approximately \$2 million in additional revenue.

STAFF NOTES. Staff concurs with the need to explore this policy option, but notes that it is impractical to implement a differential fee for these students in the Budget Year, without sufficient notice and without an analysis of the proposal by the CSU and the Board of Trustees. As such, the committee may wish to encourage the LAO and CSU to explore this option for consideration and action during the 2005-06 budget discussions.

F. ESTABLISHMENT OF "EXCESS UNIT" FEE. The Governor's Budget proposes to establish a per-unit surcharge for undergraduate students at UC and CSU who enroll in considerably more courses than are required to obtain a baccalaureate degree. Specifically, the Administration proposes charging students the full cost of instruction for each credit unit they take beyond 110 percent of the units required to obtain a baccalaureate degree. For most programs, the LAO cites that the unit cap would be set at 198 quarter units and 132 semester units. The Governor's Budget assumes that the implementation of this policy will result in General Fund savings of \$9.3 million at UC and \$24.4 million at CSU.

UC and CSU have raised a number of concerns related to the implementation of this proposal. Specifically, the institutions are concerned about which students will be subject to the surcharge. In particular, students pursuing double majors and majors that require a higher-than-average number of units would be adversely impacted by this proposal. Further, both segments have expressed concern about how the proposal would be phased-in. Finally,

UC and CSU are skeptical of the \$33.7 million in revenue estimates. UC believes, at most, it would generate \$1 million in the Budget Year, with only 500 full-time equivalent students likely being subject to the surcharge. In the out-years, UC would only expect \$10.5 million when the policy is fully phased in. At CSU, questions regarding the phasing-in of the proposal would first need to be addressed before it could give an estimate of revenue savings.

LEGISLATIVE ANALYST. The LAO recommends that the Legislature approve the proposed “excess unit” fee because it ensures that General Fund resources are targeted where they are most needed.

STAFF NOTES. Both UC and CSU, as well as the LAO, note that if the surcharge policy is effective, then most students WILL NOT pay the higher fee. Instead they will graduate or drop out rather than enrolling in excess classes and paying the higher amount. As a result, staff believes that the revenue assumed from the proposal will fail to materialize, and instead, UC or CSU will have an unallocated reduction and an open “slot” which would be filled with another student. Given that the Administration’s proposal strives to alter student behavior, it’s unclear why any General Fund savings would be associated with this new policy. As with prior proposals, this is not a policy that could be immediately implemented. Students need to be given sufficient notice of the higher fee in order to ensure they are taking the courses appropriate to their major and necessary to graduate in a timely manner. As such, staff recommends that the committee hold this issue open pending the May Revision.

II. FINANCIAL AID

BACKGROUND. Financial assistance for students comes in many forms and is offered by many entities. The major forms of financial assistance for postsecondary students includes grants (scholarships and fellowships), loans, work study, investment accounts, and tax credits. The major providers of financial assistance are the federal government, state government, universities, and private benefactors.

The state of California provides student financial aid through the Cal Grant Program, university-based institutional aid, and Governor’s Merit Scholarships. Each of the public university systems administers its own financial assistance programs (known as “campus-based financial aid”) using dollars derived from student fees and/or the state General Fund.

A. CAL GRANT PROGRAM. The Governor’s Budget proposes to substantially limit and constrict the Cal Grant entitlement program by: (1) reducing the income ceilings used to determine program eligibility; (2) reducing the maximum grant amount to students attending

private colleges and universities; and (3) reducing the maximum award amount for public college students by “de-coupling” the grant amount from fee increases.

- **Eligibility.** The Governor proposes to reduce the maximum family income necessary to be eligible for the Cal Grant A program by 10 percent, from the current level of \$69,000 to \$60,000 for a family of four. In the Cal Grant B Program, the income ceiling would be reduced from \$36,300 to \$31,600, also for a family of four. The Governor’s Budget assumes that this proposal will save \$11 million in General Fund due to fewer students qualifying for the Cal Grant entitlement program.

Cal Grant Income Ceilings (Dependent Students)				
Family Size	Cal Grants A and C		Cal Grant B	
	Current Law	2004/05 (proposed)	Current Law	2004/05 (proposed)
2	\$62,100	\$54,000	\$29,000	\$25,200
3	63,500	55,300	32,600	28,400
4	69,000	60,000	36,300	31,600
5	74,000	64,400	40,600	35,300
6 or more	79,800	69,400	43,900	38,200

LEGISLATIVE ANALYST. The LAO recommends that the Legislature deny the Governor’s proposal and adhere to current law, which adjusts the Cal Grant income ceilings on an annual basis. The LAO believes that retaining the existing eligibility pool for the Cal Grant program will assist many middle income students in covering their education expenses and will prevent the most financially-needy students (those covered under the Cal Grant B program) from falling through the cracks.

STAFF NOTES. It is unclear why the Administration is proposing to reduce the income ceilings for the Cal Grant B population in particular. These families are the lowest of the low income population, with statute indicating a lower GPA requirement for Cal Grant participation. Given that these students may not have GPA’s which would allow them to qualify for a Cal Grant A award, the proposal would have the effect of leaving lower income students with GPA’s between 2.0 (Cal Grant B requirement) and a 3.0 (Cal Grant A requirement) out of the financial aid pool entirely. Staff recommends that this issue be held open pending the May Revision.

- **Private Institution Grant Amount.** The Governor proposes to reduce the grant level for students attending private and independent colleges by 44 percent. This would result in the maximum grant level being decreased from the current amount of \$9,708 to \$5,482. The newly proposed grant level is equivalent to the proposed fee level at the UC. The

Governor's proposal would only impact new Cal Grant recipients; students currently receiving awards would retain their higher valued award. The Administration estimates that this reduction will reap \$32.7 million in General Fund savings.

LEGISLATIVE ANALYST. In response to the Governor's proposal, the LAO recommends that the Legislature adopt a statutory policy to link the award level for a private university Cal Grant to the amount of the General Fund subsidy the state provides to financially-needy students attending the UC and CSU. If the LAO's policy were implemented in the coming fiscal year, it would raise the maximum grant amount to \$9,906, costing the state a total of \$34.3 million over the amount provided in the Governor's Budget. To restore the grant to its current year level of \$9,708 will cost the state \$32.7 million more than the amount provided in the Governor's Budget.

STAFF NOTES. The Governor's proposal appears to contradict the original public policy rationale for paying a higher award level to private college students: Allowing students to make a real choice among the higher education options, and as a result, purposely redirecting a portion of the eligible postsecondary students to nonpublic institutions. The goal of the policy was to ultimately: (1) assist the state in avoiding additional costs associated with providing postsecondary education for ALL eligible students; and (2) help to manage the surging student enrollments under the Tidal Wave II population boom.

While sympathetic to the LAO's desire to develop a statutory policy to guide the level of the maximum Cal Grant award for private institutions, staff would note that programmatic statutory changes would best be dealt with via the policy committee process. In conclusion, staff recommends that this issue be held open pending the May Revision.

- **Public Institution Grant Amount.** Counter to codified Legislative intent, the Governor also proposes to dissolve the practice of increasing Cal Grant awards to cover the additional costs associated with fee increases at UC and CSU. Thus, rather than increasing the grant level to cover the proposed 10 percent fee increase, the maximum award level would remain at the current-year level. The LAO estimates that this policy change avoids \$18.7 million in General Fund costs that would otherwise need to be paid.

LEGISLATIVE ANALYST. Consistent with prior Cal Grant recommendations, the LAO encourages the Legislature to deny the Governor's proposal, increase funding for Cal Grants in order to cover the proposed fee increases, thus retaining the award levels as outlined in current law.

STAFF NOTES. Staff recommends that this issue be held open pending the May Revision.

B. INSTITUTIONAL-BASED FINANCIAL AID. The Governor's budget proposes to reduce the percentage of new fee revenue (derived as a result of the fee increase) that is set aside for campus-based financial aid programs. Under current practice, UC and CSU set-aside one-third of the revenue generated by a fee increase to provide the financial aid necessary to help offset the costs to needy students. The Governor proposes to reduce the set-aside amount to 20 percent (rather than the current 33.3 percent). The remainder of the revenue would be available to the university systems to help offset the various proposed General Fund reductions.

Under current practice, UC and CSU retain the authority to distribute these funds to students on their campuses as they see fit. Whether the set-aside for financial aid is 33.3 percent or 20 percent, funding for campus-based financial aid programs will increase in the 2004-05 fiscal year. With the proposed increases in student fees, at the 20 percent set-aside level, campus-based financial aid programs are proposed to rise for UC and CSU by \$38 million and \$26 million respectively, for a total of \$391.1 million at UC and \$217.4 million at CSU. The funding generated from the fee increases appears to be evenly derived from both undergraduate and graduate students.

LEGISLATIVE ANALYST RECOMMENDATION. The LAO contends that setting aside even 20 percent of the new fee revenue is overly excessive, citing enormous increases in campus-based financial aid budgets in the current year. Fundamentally, the LAO believes that there is a disconnect between the original intent of setting aside one-third of new fee revenue for financial aid and the current campus-based aid programs.

Consistent with prior year recommendations, the LAO proposes a more centralized approach to financial aid which would hold funding for the Cal Grant program constant (at current-year levels) while decreasing the amount of financial aid available to individual campuses. Specifically, the LAO recommends that the legislature: (1) shift \$32.2 million in *undergraduate* campus-based financial aid funding from campuses to backfill the proposed reductions in the Cal Grant program; and (2) retain the proposed increase of \$32.5 million in campus-based financial aid for *graduate* students. The intent of the LAO is to provide what it considers a more equitable distribution mechanism for a finite amount of financial aid resources.

STAFF NOTES. There are essentially two issues before the legislature related to institutional financial aid. *First* – Should the UC and CSU reduce the amount of student fee revenue that is set aside (from 33.3 percent to 20 percent) for student financial aid? Staff would note that, combined with the proposed Cal Grant reductions, the total reduction in financial aid resources will inevitably have a negative impact on students. However, if the set aside is returned to 33.3 percent, without an accompanying General Fund augmentation to backfill the proposed reductions, the net effect is simply an

“unallocated” reduction to the UC and CSU. Staff recommends that this portion of the proposal be held open, pending an update on the General Fund as part of the May Revision. *Lastly* – Pursuant to the LAO recommendation: Should the Legislature shift funding from campus-based institutional aid programs to backfill reductions in the Cal Grant program?

Contrary to the recommendations of the LAO, *staff notes* that the administration of financial aid programs appears to be moving from a state-administered, overly bureaucratic, and centralized system to one that is campus-based, student-centered, and more flexible in nature. The California Postsecondary Education Commission, in its review of the administration of the Cal Grant Program (a report which was requested by the Legislature), noted that the Cal Grant Program -- which is centrally administered by the California Student Aid Commission -- would better serve students if the administration of the program moved towards a more decentralized, campus-based model.

Further, *staff notes* that there continues to be a need to allow campus financial-aid officers to work with students to address their financial need issues mid-year and on a case-by-case basis. Many times students have unanticipated financial needs or needs that aren't reflected in their student aid application from the prior Spring. Altering the process by which campus-based financial aid dollars are allocated could make it difficult for campus financial aid officers to respond to the unique need of students and supply them with much-needed aid.

Lastly, staff would point out that there is already a reduced pool of financial aid resources for campuses to work with – given that the set aside is proposed to be reduced from 33.3 percent to 20 percent. Staff recommends that the committee deny the LAO's alternative proposal to shift and redistribute scarce financial aid resources and instead consider alternative funding sources to increase the total amount of funding available for student financial aid.

C. APLE PROGRAM. The Governor's Budget proposes to reduce the number of Assumption Program of Loans for Education (APLE) warrants from 7,700 to 3,500 (a reduction of 4,200 warrants). Since 1997-98, the number of APLE warrants has grown considerably, from 500 in 1997-98 to 7,700 in 2003-04. While there are no savings associated with the Governor's proposal in the Budget Year, a reduction in the number of APLE warrants would result in approximately \$57 million in savings over a the four-year period beginning 2006-07. Further, the Administration is also proposing to make a variety of statutory changes to the program establishing priorities for the granting of warrants. The Administration's proposal has yet to be amended into a piece of legislation, but is slated to be referred to the appropriate policy committees when that amendment occurs.

LEGISLATIVE ANALYST. The LAO does not express an opinion on the appropriate number of APLE warrants, but offers a variety of suggestions related to the proposed policy changes to the program. Staff notes that the LAO's comments would best be directed to the Senate Education and Assembly Higher Education committees during the hearing process.

STAFF NOTES. Staff recommends that this issue be held open pending information on future year revenues as part of the May Revision.

D. *EDFUND SURPLUS.* Operating under California statute, EdFund is a nonprofit "auxiliary" organization of the California Student Aid Commission which administers the Federal Family Education Loan Program (FFELP) on behalf of the state. Student loans under the FFELP are guaranteed by the federal government in order to ensure that lenders themselves do not bear the risk associated with lending money to students (who traditionally have no credit or payment history) and that students don't "pay" for this increased risk in the form of high loan fees and interest rates. In addition to FFELP, the federal government also operates a Direct Lending program which places the federal government in the role of both lender and guarantor by directly lending money to students via their educational institutions.

Colleges and universities which offer student loan programs have a choice between a variety of FFELP "guarantors" (EdFund is only one of several guarantee agencies in the country) or the federal Direct Lending program. In the mid-1990s, the Legislature and the Governor explicitly granted the Student Aid Commission's request to statutorily establish EdFund, freeing the organization of state bureaucratic constraints, so that it could actively participate in the competitive student lending and guarantee marketplace.

Since then, EdFund has been remarkably successful. So much so, that it has generated a sizable operating surplus, due to the loyalty of EdFund customers and its continued success in avoiding student loan defaults. The Student Loan Operating Fund (SLOF) surplus is relatively new and is expected to be short-term in nature. In recent years, the Legislature and the Governor shifted the operational funding for the Student Aid Commission *from* the General Fund *to* the SLOF in order to preserve General Fund resources.

LEGISLATIVE ANALYST. As part of its Analysis of the 2004-05 Budget Bill, the LAO identified the SLOF surplus as a potential funding source for other financial aid-related activities. Specifically, the LAO suggested using approximately \$60 million of SLOF monies to support UC and CSU campus-based financial aid administration, thereby offsetting and saving General Fund resources. The use of SLOF for this purpose seems to have withstood federal scrutiny when the State of New York recently made such a funding "swap"; however, staff notes that there may be other authorized and higher priority uses for these funds.

STAFF NOTES. The LAO identification of the SLOF as a source for other financial-aid related expenses has sparked a great deal of interest due to the perception that EdFund's SLOF is essentially "free money". However, staff notes that student loan programs (and the accompanying Student Loan Operating Fund) are operated under a variety of federally-imposed constraints (both statutory and contractual). Furthermore, EdFund and the Student Aid Commission have recently released a "utilization plan" which discusses EdFund's future financial needs, including the need to reinvest in technology, diversify its financial operations, and maintain a prudent reserve.

Committee staff, the Student Aid Commission, the LAO, and the Department of Finance are currently analyzing EdFund's expenditure plan and investigating the amount of money that may be available for other allowable "financial aid" purposes. Of particular interest is the option of being able to "backfill" the Governor's proposed Cal Grant reductions from this funding source. Staff recommends that this issue be held open pending the analysis of additional information.

Proposed Consent

Staff recommends that the following items be Approved as Budgeted.

- 6600-001-0001. Support, Hastings College of Law. \$8,119,000
- 6600-001-0814. Support, Hastings College of Law. California State Lottery Fund. \$152,000
- 6600-301-6028. Capital Outlay, Hastings College of Law. McAllister Street Facility: Code Compliance Update. \$18,758,000
- 7980-001-0784. Support, California Student Aid Commission. Payable from the Student Loan Operating Fund. \$12,640,000.
- 7980-101-0890. Local Assistance, California Student Aid Commission. Federal Trust Fund. \$10,221,000
- 7980-495. Reversion, California Student Aid Commission.